Missouri Bankers Association

August 16, 2022

Mr. James P. Sheesley
Assistant General Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

VIA: comments@fdic.gov
RE: RIN 3064-AF83

Dear Mr. Sheeley:

The Missouri Bankers Association is pleased to present to the Directors of the FDIC our comments regarding the proposed rule to increase initial base deposit insurance rates. The MBA and our members oppose the rule and respectfully request that the Corporation defer action and consideration of the rule for the reasons we outline below.

Summary of Proposed Rule.

The rule would increase initial base deposit insurance assessment rates charged to FDIC-insured depository institutions by two basis points until the FDIC's Deposit Insurance Fund ("DIF") reaches a Deposit Reserve Ratio ("DRR") of 2 percent of total insured deposits for all FDIC-insured institutions. The rule requirements implement a "restoration plan" to increase the DRR to the statutorily required level of 1.35 percent within 8 years of the DRR falling below that level, in accordance with the Federal Deposit Insurance Act.

FDIC Assumptions Are Out-Dated and Backward Looking.

The FDIC should withdraw the proposed rule and reconsider the position and condition of the Deposit Insurance Fund under forward looking conditions.

- The Market has Changed

  The two-basis-point increase is based on FDIC calculations using assumptions regarding total industry deposit levels and earnings levels of the DIF investment portfolio.

  These assumptions do not reflect current market information that is directly applicable. The market has changed significantly over the past several months due to unprecedented economic conditions driven by the COVID pandemic and other world events.

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- FDIC Implementation of "Cushion."

  The FDIC's targeting of the higher 2 percent DRR is intended to provide additional cushion above the statutorily mandated 1.35 percent DRR level.

  The 2 percent DRR threshold is not required by any statute and was initially set as a goal *over a decade ago*. This goal was determined prior to today's full implementation of the current major safety and soundness and capital adequacy safeguards by the banking industry.

  The need for, and amount of, any cushion needs to be determined in the context of the industry's current strength and ability to withstand economic stress.

Deposit Levels are Changing Post-Pandemic.

Primary deposits assumptions used by the FDIC to conclude that a two-basis-point assessment rate increase is necessary are outdated and inaccurate because they do not reflect current market information and trends.

- Deposit Levels Assumptions. The most critical assumption necessary for the FDIC's calculation is the amount of deposits held by FDIC-insured institutions, "Total Industry Deposits".

  However, in recent months the trajectory of Total Industry Deposits has changed drastically, and the FDIC's assumptions purporting to justify the two-basis-point assessment rate increase in the proposed rule do not take these changes into account.

- FDIC Assumptions Did Not Consider Fleeting Nature of Extraordinary Pandemic Era Deposit Growth. To justify the two-basis-point assessment rate increase, the FDIC assumed that Total Industry Deposits would continue to grow at the relatively high rate of 3.5 to 4.0 percent.

  However, Total Industry Deposits were radically inflated over the past two years due to: (1) massive U.S. government stimulus payments via pandemic relief programs, constituting the largest government rescue package in U.S. history, (2) significant practical limitations on, and curbing of, consumer and business spending that occurred as a result of government-imposed lockdowns and quarantines, and (3) market instability making bank deposits preferred investment vehicles for stability and liquidity.

- Current Data Shows Pandemic Era Deposit Trends are Reversing. In reality, current information illustrates that the surge in pandemic era Total Industry Deposit growth has already peaked and is now significantly declining. According to the Federal Reserve, the U.S. domestic commercial bank monthly growth annual rate for deposits (excluding large time deposits) peaked in early 2020 at over 80 percent and that rate had dropped to *negative* 5 percent by mid-2022.

Many community banks are now seeing their deposit totals decrease as the pandemic era factors that temporarily inflated deposit totals continue to wane. This decreasing and flattening trend in Total Industry Deposits should cause the DRR to accordingly increase far faster than the FDIC assumptions indicate, mitigating the need for a major assessment rate increase.

- Excess Temporary Pandemic Era Deposits Do Not Warrant Additional Cushion for DRR. When community banks were confronted with the pandemic era surge in deposits, most of them invested the excess deposit funds in cash and short-term U.S. Treasury securities, to allow maximum liquidity for uncertain economic times. Now that deposit levels are decreasing, this approach not only provides the needed liquidity, but, to the extent excess deposits still exist, they are invested by such banks in the safest asset classes – mitigating the need for a "cushion" above the statutorily mandated 1.35 percent DRR based on the temporary pandemic era deposit surge.

DIF Investment Portfolio Assumptions – Earnings, Interest Rate, Unrealized Losses Not Supported.

- FDIC DIF Growth and Interest Rate Assumptions Do Not Reflect Current Conditions. The FDIC also assumed that investment income (interest yield and capital gains) on securities held in the DIF would be near zero in coming years, which was another justification for the two-basis-point assessment rate increase. This assumption was also based on outdated information.

  The DIF is invested largely in U.S. Treasury securities (bills and notes) with maturities up to five years. Since 2021 through mid-2022, the interest rates on many of those securities have skyrocketed, for example with the three-year Treasury rate jumping from 0.25 percent in early 2021 to 3.50 percent in mid-2022 – a 14-fold increase in less than 18 months. Obviously, as the DIF investment portfolio turns over, these higher interest rates will cause the DIF to grow far faster than the FDIC assumptions indicate, increasing the DRR substantially and mitigating the need for a major assessment rate increase.

- Major Assessment Increase Not Warranted by DRR Decrease Due to Unrealized Losses in DIF Investment Portfolio. A significant reason that the DRR is currently below the statutory 1.35 percent level is the FDIC's recognition of unrealized losses on the DIF securities portfolio.

  However, such losses are unlikely to be relevant to any significant use of DIF funds, because rates would likely return to very low levels in such a scenario and the securities would accordingly be "in the money." The FDIC will also not likely redeem or sale a significant portion of portfolio securities prior to their maturity and thus would never realize market losses.

Banking Industry Capital *and* Loan Loss Reserves Are Higher than Pre-Financial Crisis.

The need for a major deposit insurance assessment increase – especially a large "cushion" above the statutorily required DRR level – is also mitigated by the fact that, through the reforms of the Dodd Frank Act, the banking industry is far better capitalized and holds much deeper reserves to guard against DIF losses than in the era before the financial crisis of 2008. For example, from March 31, 2007, to March 31, 2022, the banking industry has seen the following:

- Average tier-one risk-based capital ratio has increased from 10.52 percent to 13.74 percent.

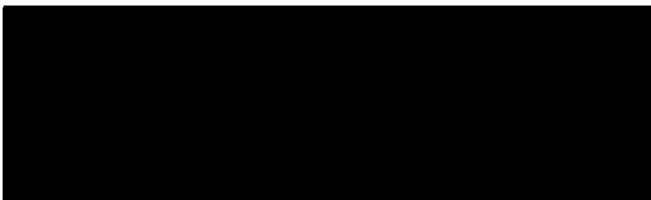
- Loan loss reserves have gone from 1 percent of loans to 1.54 percent of loans.

Conclusion

A two-basis-point increase in the FDIC assessment rate would have a significant negative economic impact on community banks in Missouri and around the U.S., potentially driving up prices for bank products and services paid by consumers and business customers. Given the points explained above, the FDIC should postpone an assessment hike in order to reconsider the crucial assumptions used to justify the significant rate increase, including consideration of more recent data and trends, and to take account of current market conditions, and give weight to structural improvements and reinforcements in the overall safety and soundness of the banking industry in recent years.

I am pleased to submit on behalf of the Missouri Bankers Association and our members.

Sincerely,



Keith Thornburg
General Counsel